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## Meet the New Test, Same as the Old Test: In re Spearing Tool's Rejection of the Revised Article 9 Rules Means Secured Creditors Will Get Fooled Again

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## Meet the New Test, Same as the Old Test: *In re Spearing Tool*'s Rejection of the Revised Article 9 Rules Means Secured Creditors Will Get Fooled Again

### *I. Introduction*

According to a recent decision by the United States Court of Appeals for the Sixth Circuit, the Internal Revenue Service (IRS) can play by its own rules when it provides notice of a claimed tax lien on a debtor's personal property and benefit from a double standard that is detrimental to the interests of ordinary secured creditors. In *United States v. Crestmark Bank (In re Spearing Tool & Manufacturing Co.)*,<sup>1</sup> the Sixth Circuit decided that requiring the IRS to put a registered organization's correct name on a federal tax lien notice filed in the public records is asking too much of the government,<sup>2</sup> even though a secured party must meet this requirement to perfect its interest in a debtor's property.<sup>3</sup> Requiring the correct name on a federal tax lien filing, however, is not unduly burdensome on the government. The IRS is certainly as capable as a secured creditor of ensuring that it has filed its claimed interest under the correct name of a registered organization.

In *In re Spearing Tool*, the Sixth Circuit gave an IRS federal tax lien priority over a competing security interest of a secured creditor.<sup>4</sup> The creditor never received notice of the tax lien, because the IRS had filed the lien under an imprecise variation of the corporate debtor's registered name.<sup>5</sup> This imprecision led to the federal tax lien never being revealed during the creditor's electronic searches for other encumbrances on the debtor's assets.<sup>6</sup> Instead of focusing on the conduct of the IRS to determine if it had provided sufficient notice of its interest, the court focused on the searches of the secured creditor, placing the burden on the creditor to show that it had done all it could to discover the federal tax lien.<sup>7</sup> The Sixth Circuit, however, should have placed the burden on the IRS to provide the correct legal name of the debtor on its federal tax lien notice, not on a subsequent creditor to guess under which name the IRS filed the lien. The Sixth Circuit could have done so by adopting the new test developed in Uniform Commercial Code Revised Article 9, which

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1. 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

2. *Id.* at 656-57.

3. *See* U.C.C. § 9-503 (amended 2000), 3 U.L.A. 357 (2002); *see also infra* Part II.C (discussing U.C.C. § 9-503).

4. *In re Spearing Tool*, 412 F.3d at 657.

5. *Id.* at 656.

6. *Id.* at 655.

7. *Id.* at 656.

provides a simplified and objective standard for determining the sufficiency of a name designation on a notice. Adoption of the Revised Article 9 standard would have allowed a secured creditor to be assured it has conducted a thorough enough search to prevent the federal government from claiming priority to property in which the creditor has a security interest. The court decided against this approach, instead providing a ruling that only adds to the confusion generated by a long line of bad case law.<sup>8</sup>

Part II of this note examines the relevant provisions of both the Federal Tax Lien Act of 1966 (FTLA)<sup>9</sup> and Revised Article 9 of the Uniform Commercial Code (U.C.C.), as well as the erratic and often contradictory prior case law that led to the adoption of the rule in Revised Article 9. Part III examines the facts leading up to the Sixth Circuit's decision in *In re Spearing Tool* and sets forth the court's reasoning in holding for the IRS. Part IV analyzes the reasoning and policy considerations used by the Sixth Circuit in *In re Spearing Tool* and compares them to the better policy under Revised Article 9.<sup>10</sup>

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8. See discussion *infra* Part II.B.

9. Pub. L. No. 89-719, 80 Stat. 1125 (codified as amended in scattered sections of 26 U.S.C., 28 U.S.C. & 40 U.S.C.).

10. This note focuses on the sufficiency of the designation used by the IRS when it files notice of a federal tax lien on the property of a registered organization, as defined in U.C.C. section 9-102. See U.C.C. § 9-102(a)(70) (amended 2001), 3 U.L.A. 15 (Supp. 2006) (defining a "registered organization" as "an organization organized solely under the law of a single State or the United States and as to which the State or the United States must maintain a public record showing the organization to have been organized"). A related issue is the sufficiency of the designation of tax debtors other than registered organizations, such as an individual taxpayer or a partnership not having an official name registered with the secretary of state that is readily accessible and verifiable. While many aspects of these issues are the same, different considerations could be involved. *But cf.* Barkley Clark & Barbara Clark, *Kansas Secretary of State Speaks on "Nickname" Filing Issue*, CLARKS' SECURED TRANSACTIONS MONTHLY, Mar. 2004, at 3, 5 (arguing that "[t]he same principles apply to individual debtor names," and "[i]n both situations, the courts should place the burden where it belongs — on the filing party and not on subsequent searchers to guess at possible typographical, spelling or other errors which render the filing invisible to the computer search logic. The object is to get it right, not close." (internal quotation marks omitted)).

Additionally, two other issues involve meshing the FTLA with Revised Article 9 that, while not presented in *In re Spearing Tool*, deserve mention: (1) when the debtor is a registered organization, in which state should a federal tax lien notice be filed, and (2) where in that state should the notice be filed. First, the FTLA and the regulations enforcing it require the notice of a federal tax lien to be filed in the state where a taxpayer "resides," which is defined for a registered organization as the state where it has its "principal executive office." I.R.C. § 6323(f)(2) (2000); Treas. Reg. § 301.6323(f)-1(b) (as amended in 1994). U.C.C. filings, however, are filed in the state where the organization is registered. U.C.C. § 9-307(e) (amended 2000), 3 U.L.A. 169 (2002). Therefore, if a corporation is incorporated in Delaware but has its principal executive office in Oklahoma, then a third party searching for encumbrances on the assets of the corporation must search with the Delaware central filing office for U.C.C.

*II. The Federal Tax Lien Act, Uniform Commercial Code Revised Article 9, and the Case Law Prior to In re Spearing Tool*

Determining the priority relationships among federal tax liens and other third-party interests is a function of both the Federal Tax Lien Act of 1966 and Revised Article 9 of the U.C.C., which has been adopted in all fifty states.<sup>11</sup> Until the recent revisions to Article 9, courts used the same standard for both U.C.C. financing statements and federal tax lien filings to resolve whether the filer had sufficiently identified the debtor so as to provide notice to third parties of its interest in the debtor's property.<sup>12</sup> The case law that developed under this standard, however, demonstrated the need for a better test. In recognition of this need, the National Conference of Commissioners on Uniform State Laws created a more commercially reasonable standard in Revised Article 9, which the Sixth Circuit should have adopted for federal tax lien filings.

*A. Playing Fair: Notice Under the Federal Tax Lien Act*

In 1913, Congress first enacted legislation regarding federal tax liens to protect the rights of certain other creditors.<sup>13</sup> Congress wanted to safeguard certain creditor interests against secret federal tax liens and, thus, required the public filing of the tax lien before it could become effective against these

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financing statements and conduct separate searches with the Oklahoma central filing office for federal tax liens. This is inefficient as it results in the need to conduct multiple searches. The FTLA should be amended to incorporate the Article 9 rule which, like the U.C.C. section 9-503 rule on sufficient designations, is objectively verifiable and can increase certainty and accuracy over the more subjective and fact-dependent principal executive office rule currently used by the FTLA.

Second, under Revised Article 9, nearly all financing statements are filed with the secretary of state's office for each state, with the only exceptions being for as-extracted collateral, timber to be cut, and fixtures, which are still filed locally in the county in which they are located. U.C.C. § 9-501 (amended 2000), 3 U.L.A. 341 (2002). Under the Uniform Federal Lien Registration Act (UFLRA), however, only federal liens against the personal property of corporations, partnerships, trusts, and decedents' estates are required to be filed in the secretary of state's office. UNIF. FED. LIEN REGISTRATION ACT § 2(c)(1)-(3), 7A U.L.A. pt. I, at 337-38 (2002). With regard to all other taxpayers, the UFLRA permits states to designate any office for the filing of federal liens, with the result being that many states use local county offices. *Id.* § 2(c)(4), 7A U.L.A. pt. I, at 338. This also results in an inefficient and unnecessary need to conduct multiple searches for interests in personal property.

11. See U.C.C. art. 9, Adoption of Revised Article 9 (2000), 3 U.L.A. 14-18 (2002).

12. See, e.g., *Citizens Nat'l Bank & Trust Co. v. Star Auto. Warehouse, Inc.* (*In re Thriftway Auto Supply, Inc.*), 39 F.3d 1193 (10th Cir. 1994) (unpublished table decision), 1994 WL 637047; *In re Mines Tire Co.*, 194 B.R. 23 (Bankr. W.D.N.Y. 1996).

13. Act of Mar. 4, 1913, ch. 166, 37 Stat. 1016.

interests.<sup>14</sup> While examining the history of the federal tax lien in a recent decision, the United States Supreme Court stated that “in sum, each time Congress revisited the federal tax lien, it ameliorated its original harsh impact on other secured creditors of the delinquent taxpayer.”<sup>15</sup> The FTLA significantly amended the Internal Revenue Code’s priority rules for federal tax liens by providing more protections for the interests of secured creditors.<sup>16</sup> “[C]onform[ing] the lien provisions of the internal revenue laws to the concepts developed in [the] Uniform Commercial Code” was one of the key purposes of the amendments, aimed at improving “the status of private secured creditors.”<sup>17</sup>

The relevant portion of the FTLA is located in §§ 6321 through 6323 of the Internal Revenue Code (I.R.C.). Section 6321 of the FTLA grants a lien in favor of the United States on all the real and personal property of any delinquent taxpayer for the amount of the tax deficiency.<sup>18</sup> Such federal tax liens, however, are subject to the priority rules set forth in I.R.C. § 6323, which provide the key safeguards protecting the interests of secured creditors under the U.C.C. Section 6323 provides that a federal tax lien imposed by the IRS under § 6321 will not be valid against the interests of other secured parties until notice of the government’s claim has been properly filed by the Secretary of the Treasury.<sup>19</sup> Such notice must be filed, “[i]n the case of personal property, whether tangible or intangible, in one office within the State . . . as designated by the laws of such State, in which the property subject to the lien is situated.”<sup>20</sup> Additionally, § 6323(f)(3) provides that the Secretary of the Treasury will prescribe the form and content of the required notice of the liens.<sup>21</sup> Thus, the FTLA preempts state law such that the notice prescribed by the Secretary “shall be valid notwithstanding any other provision of law

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14. *Id.*; see also *United States v. Pioneer Am. Ins. Co.*, 374 U.S. 84, 89 (1963). The legislation initially protected the interests of mortgagees, purchasers, and judgment creditors, see ch. 166, 37 Stat. at 1016, and was later broadened to include pledgees and holders of certain securities, see, e.g., Federal Tax Lien Act sec. 101, § 6323(a), 80 Stat. at 1125.

15. *United States v. Estate of Romani*, 523 U.S. 517, 524 (1998).

16. See I.R.C. §§ 6321-6323 (2000).

17. *Manalis Fin. Co. v. United States*, 611 F.2d 1270, 1273 (9th Cir. 1980) (third alteration in original) (quoting H.R. REP. NO. 89-1884, at 1-2 (1966)).

18. I.R.C. § 6321.

19. *Id.* § 6323.

20. *Id.* § 6323(f)(1)(A)(ii). Former Article 9 of the U.C.C. also required security interests to be filed in the state where the property was located. See U.C.C. § 9-103 (1995), 3A U.L.A. 373 (2002). Revised Article 9, however, requires for security interests to be filed, in most cases, where the debtor is located, as determined under section 9-307. See U.C.C. § 9-301 & cmt. (amended 2000), 3 U.L.A. 154 (2002).

21. I.R.C. § 6323(f)(3).

regarding the form or content of a notice of lien.”<sup>22</sup> In addition to the statute, the Treasury Regulations require that the notice be filed on *Form 668 — Notice of Federal Tax Lien Under Internal Revenue Laws* and that the notice “identify the taxpayer, the tax liability giving rise to the lien, and the date the assessment arose.”<sup>23</sup>

While the regulations provide the form to be used by the IRS for filing notices, the statute and the regulations contain gaps that fail to set forth specifics for completing the form. Significantly, the precise requirements for the designation used by the IRS on the filing are not prescribed by the FTLA. The Treasury Regulations merely provide that the filing must “identify” the taxpayer without stating what constitutes sufficient identification.<sup>24</sup> Previously, courts used the “reasonably diligent searcher” standard to determine whether the filing sufficiently identified the taxpayer so as to satisfy the requirement that the IRS provide notice of its lien. This highly subjective and fact-intensive test was used to determine the sufficiency of U.C.C. filings under former Article 9,<sup>25</sup> but led to unpredictable, inconsistent outcomes.<sup>26</sup> Because of the many problems this test posed for U.C.C. filings, the authors of Revised Article 9 replaced it with a much more workable standard developed in section 9-503.<sup>27</sup> Instead of adopting the Revised Article 9 standard for federal tax lien filings, the Sixth Circuit merely recharacterized the previously used standard as a “reasonable and diligent electronic search” to account for the fact that Michigan uses an electronic filing system. After the Sixth Circuit’s decision in *In re Spearing Tool*, it has been suggested that the FTLA should once again be updated to conform to Revised Article 9 and that courts should adopt the Revised Article 9 test to determine the sufficiency of the name used in federal tax lien filings.<sup>28</sup>

#### *B. Into the Morass: Case Law Prior to In re Spearing Tool*

The case law prior to the decision in *In re Spearing Tool* followed the “reasonably diligent searcher” standard. This standard had originally developed to determine the sufficiency of notice for U.C.C. filings under

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22. *Id.*

23. Treas. Reg. § 301.6323(f)-1(d) (as amended in 1994).

24. *Id.*

25. *See, e.g.,* Tony Thornton Auction Serv., Inc. v. United States, 791 F.2d 635, 639 (8th Cir. 1986).

26. *See* discussion *infra* Part II.B.

27. *See infra* Part II.C (discussing the test in U.C.C. Revised Article 9).

28. Barkley Clark & Barbara Clark, *Sixth Circuit Rules IRS Exempt from UCC Filing Requirements, Creating New Searching Headaches for Secured Lenders*, CLARKS’ SECURED TRANSACTIONS MONTHLY, July 2005, at 1, 3.

former Article 9.<sup>29</sup> As described above,<sup>30</sup> the test is fact-intensive and has resulted in “muddled” case law that is inconsistent and unhelpful in guiding future decisions regarding both federal tax lien filings and U.C.C. financing statements.<sup>31</sup> The test was developed at a time when all filings were indexed alphabetically in books that could be physically searched. In such situations, imperfect or imprecise debtor name variations were likely to be found on the same page as the debtor’s correct name. Because of the many problems resulting from the subjective nature of the reasonably diligent searcher standard, replacing it with a new test, like the one developed in Revised Article 9, was desirable whether or not the technology of filing notices changed. The change to electronic filing and search systems, however, has only further complicated what was already a confusing test.<sup>32</sup>

As demonstrated in the body of case law using the reasonably diligent searcher standard, this test could not be objectively applied; rather, the outcome of each particular case depended entirely on the circumstances surrounding the individual case and, thus, did not provide adequate guidance for resolving future conflicts. Cases with extremely similar fact patterns but heard in different jurisdictions often resulted in completely disparate outcomes. Because courts attempted to determine whether the name used to identify a taxpayer gave sufficient notice of a federal tax lien to a third party, the outcomes of these cases were heavily dependent on each state’s system for filing notices. A misspelling or misdesignation that, on account of a particular state’s filing system, resulted in the notice being filed on the same page as if it had correctly designated the taxpayer would constitute sufficient identification, whereas the same misspelling or misdesignation could constitute insufficient identification in another state because that state’s system would cause the notice to be filed ten pages away. Furthermore, misspelling “Friedlander” as “Freidlander” still sufficiently identified the taxpayer in one jurisdiction, but misspelling “Castillo” as “Castello” rendered the notice of federal tax lien ineffective in another.<sup>33</sup> In one instance an incorrect middle initial was determined not to affect the sufficiency of notice, while in other

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29. *Tony Thornton Auction Serv.*, 791 F.2d at 639.

30. *See supra* text accompanying notes 25-26.

31. Barkley Clark & Barbara Clark, *In Filing Federal Tax Lien Notices, IRS Need Not Follow New UCC Rules Governing Debtor Names*, CLARKS’ SECURED TRANSACTIONS MONTHLY, Sept. 2003, at 1, 3.

32. Marsha E. Simms, *Introduction to Secured Lending and Commercial Finance*, in ASSET BASED FINANCING 2005, at 9, 21 (PLI Commercial Law & Practice, Course Handbook Series No. A-878, 2005).

33. *Compare* Richter’s Loan Co. v. United States, 235 F.2d 753 (5th Cir. 1956) (misspelling Friedlander), *with* Haye v. United States, 461 F. Supp. 1168 (C.D. Cal. 1978) (misspelling Castillo).

instances the incorrect middle initial invalidated otherwise properly filed liens.<sup>34</sup> Such case inconsistencies only increased the confusion surrounding the application of the standard.

The cases the Sixth Circuit cited in *In re Spearing Tool* to support its holding are no less troublesome than those discussed above. The Sixth Circuit cited these cases for the proposition that the IRS does not have to identify the taxpayer perfectly in its federal tax lien filings. In *Tony Thornton Auction Service, Inc. v. United States*, a case the Sixth Circuit relied on in *In re Spearing Tool*, the Eighth Circuit held that notice of a federal tax lien against a restaurant was valid even though the notice contained only the names of the husband and the restaurant, but not the name of the wife who was a business partner.<sup>35</sup> In a later case, however, the Bankruptcy Court for the District of Pennsylvania declined to follow *Thornton*, holding a notice of federal tax lien insufficient against an individual partner, where the notice only identified the partnership and the individual's wife as general partner.<sup>36</sup> In *In re Hudgins*, a second case cited by the Sixth Circuit, the Fourth Circuit held that a notice of lien filed against "Hudgins Masonry Inc." did not sufficiently identify the individual taxpayer Michael Hudgins.<sup>37</sup> Therefore, the filing provided constructive notice with regard to business-related assets only, but not against nonbusiness assets.<sup>38</sup> Unfortunately, the Sixth Circuit's decision in *In re Spearing Tool* only dragged the problems and inconsistencies presented by the prior case law into the computer age, by recharacterizing the old reasonably diligent searcher standard as the "reasonable and diligent electronic search."<sup>39</sup>

### C. Commercial Reasonableness: The Revisions to U.C.C. Article 9

The same notice problems that plagued the courts hearing federal tax lien cases afflicted U.C.C. financing statement litigation. The need to increase commercial certainty with regard to filing requirements prompted the revisions to Article 9.<sup>40</sup> Precision, certainty, and predictability are very important to

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34. Compare *Brightwell v. United States*, 805 F. Supp. 1464 (S.D. Ind. 1995) (finding that the notice of a federal tax lien was sufficient even though it stated the incorrect middle initial for a taxpayer and inserted an extra space in his last name), with *Fritschler, Pellino, Schrank & Rosen, S.C. v. United States*, 716 F. Supp. 1157 (E.D. Wis. 1988) (holding that an incorrect middle initial rendered the notice of a federal tax lien invalid), and *Cont'l Invs. v. United States*, 142 F. Supp. 542 (W.D. Tenn. 1953) (same).

35. *Tony Thornton Auction Serv., Inc. v. United States*, 791 F.2d 635, 639 (8th Cir. 1986).

36. *Focht v. United States (In re Focht)*, 243 B.R. 263, 266-67 (Bankr. W.D. Pa. 1999).

37. *Hudgins v. IRS (In re Hudgins)*, 967 F.2d 973, 977 (4th Cir. 1992).

38. *Id.*

39. *United States v. Crestmark Bank (In re Spearing Tool & Mfg. Co.)*, 412 F.3d 653, 656 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

40. *Barkley Clark & Barbara Clark, Kansas Bankruptcy Court Okays Debtor's Nickname*



sustain an effective and efficient filing system.<sup>41</sup> Specifically, a new test for determining the sufficiency of name designations on U.C.C. notice-filings was needed to replace the convoluted case law that had developed around the old “reasonably diligent searcher” standard and to account for the changes in technology that led to the adoption of computerized filing systems by the state records offices. Sections 9-503 and 9-506 were revisions adopted to provide clear standards for establishing a debtor’s correct name and for determining when an incorrect name on a financing statement is insufficient.<sup>42</sup> The Article 9 revisions were designed to clarify the filing requirements in order to “discourage the fanatical and impossibly refined reading of statutory requirements in which courts occasionally had indulged themselves.”<sup>43</sup> In today’s environment, the stricter requirements of Revised Article 9 are especially helpful because “[t]he advent of computer searches has only added to the confusion” caused by the bad case law developed under the old reasonably diligent searcher standard.<sup>44</sup>

The Revised Article 9 test is found in U.C.C. section 9-503(a)(1). It provides that, when the debtor is a registered organization, a financing statement sufficiently identifies the debtor only if it uses the name indicated on the public record registered in the jurisdiction where the debtor was organized.<sup>45</sup> This requirement in Revised Article 9 enhances certainty and predictability by creating a clear rule for U.C.C. filings.<sup>46</sup> The test under Revised Article 9 is both objective and practical.<sup>47</sup> As long as a searcher can accurately determine the debtor’s correct legal name and its jurisdiction of organization, that searcher need only run one search to discover any and all prior U.C.C. security interests filed against the debtor.<sup>48</sup> This rule allows a lender to know both that the search under the debtor’s correct legal name has revealed all prior interests that could be effective against its own interest, and that the lender’s own security interest if filed under this same name will constitute sufficient notice of its interest to later creditors. The Revised Article 9 rule increases certainty and predictability, and decreases litigation over the

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on *UCC Financing Statement*, CLARKS’ SECURED TRANSACTIONS MONTHLY, Sept. 2003, at 3, 5.

41. *Id.*

42. U.C.C. § 9-101 cmt. 4(h) (amended 2000), 3 U.L.A. 44-46 (2002).

43. *Id.* § 9-506 cmt. 2, 3 U.L.A. 363 (2002).

44. Simms, *supra* note 32, at 21.

45. U.C.C. § 9-503(a)(1), 3 U.L.A. 357 (2002).

46. Clark & Clark, *supra* note 28, at 2. The clear rule is “one of the major advantages of Revised Article 9.” *Id.*

47. Stephen D. Sayre & Darrell Pierce, *Secured Lenders Beware: IRS Plays by Its Own Rules in Filing Federal Tax Liens*, SECURED LENDER, Sept./Oct. 2005, at 28, 28.

48. *Id.*

sufficiency of the name.<sup>49</sup> The revision also reduces transaction costs by eliminating the expense of conducting multiple searches, as well as through minimizing incorrect matches and the resulting due diligence costs required to determine the applicability of those incorrect matches.<sup>50</sup>

Not all errors in a name designation, however, are fatal. Section 9-506(a) provides that minor errors or omissions will not render a financing statement ineffective, unless the errors or omissions make the financing statement seriously misleading.<sup>51</sup> The test to determine if an error is seriously misleading is provided in subsections (b) and (c) of section 9-506, which provide that a financing statement is per se seriously misleading when it fails to use the name of the debtor required by section 9-503(a); if, however, a financing statement with an error in the name is disclosed during “a search of the records of the filing office under the debtor’s correct name, using the filing office’s standard search logic, if any, . . . [then] the name provided does not make the financing statement seriously misleading.”<sup>52</sup> Thus, if an incorrectly named financing statement shows up in the search results when a third party searches for encumbrances under a debtor’s correct name, then the incorrect designation suffices to put the searcher on notice of the secured party’s interest in the property of the debtor. For example, the search logic of the computerized filing system in many states is programmed so that a notice of lien filed under “ABC Co.” will be disclosed when a search is run for “ABC Inc.”<sup>53</sup> In such a case, the imprecise variation in the designation is not “seriously misleading” under the standard set forth in section 9-506 and, therefore, sufficiently provides the name of the debtor. Regarding U.C.C. financing statements, courts have embraced the revised test and abandoned the reasonably diligent searcher standard and its attendant problems.

### *III. In re Spearing Tool & Manufacturing Co.*

*In re Spearing Tool* represented the first opportunity for a federal court of appeals to examine the issue of the sufficiency of a name designation in a notice of federal tax lien since the revisions to Article 9. The Sixth Circuit decided *In re Spearing Tool* on June 21, 2005, after receiving it on appeal from the Bankruptcy Court for the Eastern District of Michigan and the United

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49. Clark & Clark, *supra* note 28, at 2; Sayre & Pierce, *supra* note 47, at 28, 30, 32.

50. Sayre & Pierce, *supra* note 47, at 30; *see also* discussion *infra* Part IV.B.2.

51. U.C.C. § 9-506(a) (amended 2000), 3 U.L.A. 362 (2002).

52. *Id.* § 9-506(b)-(c), 3 U.L.A. 362-63 (2002).

53. The standard computer search logic of the Michigan Secretary of State’s office contained this type of programmable departure. *See* United States v. Crestmark Bank (*In re Spearing Tool & Mfg. Co.*), 412 F.3d 653, 655 n.2 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

States District Court for the Eastern District of Michigan.<sup>54</sup> Even though Revised Article 9 had been quickly adopted by all fifty states, as well as by the District of Columbia and the U.S. Virgin Islands,<sup>55</sup> the Sixth Circuit chose not to apply the uniform standard created in those revisions equally to the U.S. government.

*A. Facts*

Spearing Tool and Manufacturing Co. entered into a lending agreement with Crestmark Bank in April of 1998.<sup>56</sup> Spearing granted Crestmark a security interest in all of its assets, including its accounts receivable, which Crestmark perfected by filing a U.C.C. financing statement.<sup>57</sup> The financing statement identified Spearing by its exact name as it was registered with the Michigan Secretary of State,<sup>58</sup> as required by Michigan law.<sup>59</sup> In April, 2001, Crestmark entered into a secured financing arrangement with Spearing, under which Crestmark agreed to purchase accounts receivable from Spearing in exchange for a secured interest in all of Spearing's assets.<sup>60</sup> Crestmark filed a U.C.C. financing statement to perfect its security interest, using Spearing's precise registered name.<sup>61</sup> Because Spearing had fallen behind in its federal employment-tax payments, federal tax liens arose upon all of Spearing's property, and on October 15, 2001, the IRS filed two notices of its interest in Spearing's assets with the Michigan Secretary of State's office.<sup>62</sup> The IRS, however, filed the notices of the tax liens under the name "SPEARING TOOL & MFG. COMPANY INC.," not the organization's precise registered name, "Spearing Tool and Manufacturing Co."<sup>63</sup>

Because of Michigan's filing system and the manner in which searches must be conducted,<sup>64</sup> the IRS's use of an ampersand and the abbreviation "Mfg." frustrated Crestmark's subsequent searches for encumbrances on Spearing's property. Before advancing Spearing more funds, Crestmark submitted

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54. *Id.* at 653.

55. *See* U.C.C. art. 9, Adoption of Revised Article 9 (2000), 3 U.L.A. 14-18 (2002).

56. *In re Spearing Tool*, 412 F.3d at 654.

57. *Id.*

58. *Id.*

59. *See* MICH. COMP. LAWS ANN. § 440.9503(1) (West 2003) (correlating to U.C.C. § 9-503(a)(1)).

60. *In re Spearing Tool*, 412 F.3d at 654.

61. *Id.*

62. *Id.*

63. *Id.*

64. Michigan uses a computerized filing system; third parties searching for notices of liens must submit the name of the debtor to the Secretary of State's office, which then enters the name into its electronic search system and returns the results to the third party. *Id.* at 655.

periodic lien search requests to the Michigan Secretary of State to determine whether any encumbrances existed on Spearing's assets.<sup>65</sup> Crestmark made the requests using Spearing's precise registered name.<sup>66</sup> Because the tax lien notices were not filed under Spearing's precise registered name, the IRS tax liens were not disclosed to Crestmark in the search results.<sup>67</sup> In reliance on the absence of liens revealed by search results, Crestmark advanced funds to Spearing between October 15, 2001, the date the IRS filed its notices under the incorrect name, and April 6, 2002.<sup>68</sup> Repayment was secured by Spearing's assets.<sup>69</sup>

Spearing filed a Chapter 11 bankruptcy petition on April 16, 2002.<sup>70</sup> Two days later, the Bankruptcy Court entered a consent order providing "for a \$200,000 reserve account to be managed by Crestmark and funded by pre-petition accounts receivable collections."<sup>71</sup> The reserve account held \$153,058.33 — the amount in controversy between Crestmark and the IRS.<sup>72</sup> Crestmark claimed that the funds in the reserve account belonged to it based on its perfected security interest, while the IRS claimed priority based on its federal tax lien.<sup>73</sup> The Bankruptcy Court's order "reserved for future determination the respective rights of Crestmark and the IRS in the account balance."<sup>74</sup> On September 20, 2002, Crestmark filed a complaint to determine lien priority, which would resolve whether Crestmark or the IRS possessed the right to the funds in the reserve account.<sup>75</sup> The Bankruptcy Court for the Eastern District of Michigan granted summary judgment in favor of the government, while the United States District Court for the Eastern District of Michigan reversed, determining that Crestmark had priority.<sup>76</sup>

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65. *Id.*

66. *Id.*

67. *Id.*

68. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 302 B.R. 351, 352-53 (E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

69. *In re Spearing Tool*, 412 F.3d at 654.

70. *Id.* at 655.

71. *In re Spearing Tool*, 302 B.R. at 353.

72. *Id.* Priority for future advances between competing security interests relates to the original perfection. U.C.C. §§ 9-322 to -323 (amended 2000), 3 U.L.A. 228-30, 236-37 (2002).

73. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 292 B.R. 579, 580 (Bankr. E.D. Mich. 2003), *rev'd*, 302 B.R. 351 (E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

74. *Id.*

75. *Id.*

76. *In re Spearing Tool*, 412 F.3d at 655.

*B. The Sixth Circuit's Holding and Reasoning*

The Sixth Circuit framed the issues as “whether state or federal law determines the sufficiency of the IRS’s tax-lien notices, and whether the IRS notices sufficed to give the IRS liens priority.”<sup>77</sup> The Sixth Circuit reversed the district court and affirmed the bankruptcy court’s grant of summary judgment for the government. The Sixth Circuit held that federal law governs the form and content of the tax-lien notices, and that the notice in this case sufficed.<sup>78</sup>

The Sixth Circuit quoted I.R.C. § 6323(f)(3) and Treasury Regulation section 301.6323(f)-1(d)(1) to determine whether federal law controlled the form and content of the IRS’s tax-lien notices.<sup>79</sup> These provisions expressly provide that the Federal Tax Lien Act preempts state law, and therefore the act and the regulations implementing it control the form and content of the filings.<sup>80</sup> Thus, the court stated that all it needed to determine was whether the notice provided by the filing of the federal tax liens was sufficient to give the IRS priority over Crestmark’s competing interest.<sup>81</sup>

The Sixth Circuit began its analysis as to whether the IRS notices sufficiently identified Spearing to give the liens priority over Crestmark’s security interest by citing *Tony Thornton Auction Service, Inc. v. United States*.<sup>82</sup> The court held that an erroneous name sufficiently identifies a taxpayer if a “reasonable and diligent search would have revealed the existence of the notices of the federal tax liens under these names.”<sup>83</sup> Because Michigan uses an electronic-search system, however, the court ruled that previous case law was not relevant and that, therefore, the question was “whether Crestmark conducted a reasonable and diligent *electronic* search.”<sup>84</sup> The court held that the abbreviations used in the liens were common, and that “Crestmark had notice that Spearing sometimes used [the] abbreviations, and the Michigan Secretary of State’s office *recommended* a search using the abbreviations.”<sup>85</sup> Therefore, because Crestmark failed to use the abbreviations in its search, the

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77. *Id.*

78. *Id.* at 655-57.

79. *Id.* at 655.

80. *See id.*; *see also* I.R.C. § 6323(f)(3) (2000); Treas. Reg. § 301.6323(f)-1(d)(1) (as amended in 1994).

81. *In re Spearing Tool*, 412 F.3d at 656.

82. *Id.* (citing *Tony Thornton Auction Serv., Inc. v. United States*, 791 F.2d 635, 639 (8th Cir. 1986)).

83. *Id.* (citing *Tony Thornton Auction Serv.*, 791 F.2d at 639).

84. *Id.* (emphasis added).

85. *Id.*

Sixth Circuit concluded that Crestmark did not perform a reasonable and diligent electronic search.<sup>86</sup>

The court limited its decision, however, to the exact facts presented before it, expressly stating that it had “no opinion about whether creditors have a general obligation to search name variations.”<sup>87</sup> The court then cited policy considerations for its holding, stating that requiring the government to put the taxpayer’s correct name on the tax liens would be “unduly burdensome.”<sup>88</sup> The Sixth Circuit also held that requiring the federal government to conform to the different identification requirements of each state’s electronic search technology “would run counter to the principle of uniformity which has long been the accepted practice in the field of federal taxation,” quoting language from the U.S. Supreme Court in *United States v. Union Central Life Insurance Co.*<sup>89</sup> Finally, citing *United States v. Kimbell Foods, Inc.*,<sup>90</sup> the Sixth Circuit stated that the need for prompt, effective tax collection trumps any inconvenience that results for secured creditors.<sup>91</sup>

#### *IV. Analysis: The Flawed Approach of the Sixth Circuit and the Better Policy of Revised Article 9*

After the Sixth Circuit created its “new” standard in *In re Spearing Tool*, it summarily concluded that Crestmark did not meet this standard. The court provided no guidance for determining how a searcher meets the standard, or even if a searcher actually has any duty at all to search name variations under it. Furthermore, the court attempted to bolster its conclusion upon a policy of uniformity in federal taxation without defining uniformity in this context or how uniformity would be threatened by requiring the IRS to use a taxpayer’s registered name on its federal tax lien filings. The court should have adopted the Revised Article 9 standard because it would have established a clear, beneficial test for both searchers and the IRS, would have reduced litigation over this issue, and would not have been burdensome on the IRS.

##### *A. Continuing the Confusion: The Sixth Circuit’s Not-So-New Standard*

The court’s decision in *In re Spearing Tool* presents two main problems. First, the Sixth Circuit’s analysis overly discounted the importance of the

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86. *Id.*

87. *Id.*

88. *Id.*

89. *Id.* at 657 (quoting *United States v. Union Cent. Life Ins. Co.*, 368 U.S. 291, 294 (1961)).

90. 440 U.S. 715 (1979).

91. *In re Spearing Tool*, 412 F.3d at 657 (citing *Kimbell Foods*, 440 U.S. at 734-35, 737-38).

individual state's filing system in determining whether notice is sufficient, and misconstrued the stated policy of uniformity in the field of tax collection from the *Kimbell Foods* and *Union Central Life Insurance* cases. Second, the Sixth Circuit announced a new test for determining whether notice provided in an electronic search system is sufficient, but did not provide any guidance on how that test should be used in future cases. In reality, the court created a test no different than the old reasonably diligent searcher standard that Revised Article 9 replaced as unworkable.

*1. The Fall-Back Policy: The "Principle of Uniformity"*

The Sixth Circuit cited both *Kimbell Foods* and *Union Central Life Insurance* for a "principle of uniformity" that required the court not to "subject the federal government to different identification requirements . . . varying with each state's electronic-search technology."<sup>92</sup> This policy argument is troubling as the court determined that it must disregard the individual state's method for filing notices while, at the same time, it observed that Michigan's use of an electronic-search system required a different standard than what would be used in a jurisdiction with a physical index.<sup>93</sup> In analyzing this case, the United States District Court for the Eastern District of Michigan concluded that, when courts apply the reasonable and diligent search test to determine sufficiency of notice, they "necessarily consider the recording method employed by the state or county."<sup>94</sup> The Sixth Circuit acknowledged that a local system of recording notices does make a difference in analyzing whether that notice is sufficient, at least to some extent, when it judged Crestmark's search by a reasonable and diligent electronic search standard as opposed to the standard of a reasonable and diligent search of a physical index.<sup>95</sup>

Prior case law also weakens the Sixth Circuit's "principle of uniformity" policy argument. In much of the prior case law, courts have indeed taken into account the individual state's filing system to determine whether appropriate or sufficient notice was given, as the district court stated.<sup>96</sup> In fact, the cases the Sixth Circuit cited as suggesting that a federal tax lien does not need to identify the taxpayer perfectly were decided after taking into consideration the respective state's lien index.<sup>97</sup> In discussing *In re Hudgins*,<sup>98</sup> where a lien that

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92. *Id.*

93. *Id.* at 656.

94. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 302 B.R. 351, 355 (E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

95. *In re Spearing Tool*, 412 F.3d at 656.

96. See discussion *supra* Part II.B.

97. See *Hudgins v. IRS (In re Hudgins)*, 967 F.2d 973, 977 (4th Cir. 1992); Tony Thornton Auction Serv., Inc. v. United States, 791 F.2d 635, 638 (8th Cir. 1986); Reid v. IRS (*In re Reid*),

should have been filed against “Michael Hudgins” was incorrectly filed against “Hudgins Masonry, Inc.,” the Sixth Circuit explained that the “notice nonetheless sufficed, given that both names would be listed on the same page of the state’s lien index.”<sup>99</sup> The outcome of this case was heavily influenced by the individual state’s filing system, because, had the filing system been altered so that the two names would not have been listed on the same page, the notice probably would not have sufficed. Thus, it seems incongruous for the Sixth Circuit to later state that, based on a policy consideration of uniformity, a state’s system will not be a factor in determining IRS compliance with the notice requirement.<sup>100</sup> Whether termed a reasonable and diligent search or a reasonable and diligent *electronic* search, under a subjective, fact-dependent test, the individual state’s method of searching for notices must play a part in the decision.

Additionally, because every state has adopted Revised Article 9, the Sixth Circuit’s fears that uniformity would be undermined are misplaced.<sup>101</sup> Requiring the IRS to file federal tax liens under a company’s correct registered name according to U.C.C. section 9-503(a)(1) would better serve a policy of uniformity, because a creditor would discover the federal tax lien in its search regardless of the standard or logic employed in the particular state. Any system would reveal a lien filed under a debtor company’s correct name as registered with the Secretary of State, and notice of the federal tax lien would, therefore, be sufficient. Thus, with such a rule, the IRS would not be subjected to “different identification requirements . . . varying with each state’s electronic-search technology,” as the Sixth Circuit worried.<sup>102</sup> Rather, the U.C.C. provision would promote a single uniform identification requirement that would not depend upon each state’s individual system for filing notices. Not only would such a requirement better serve a policy of uniformity, it would also greatly decrease litigation over the issue of sufficient notice, thus cleaning up prior convoluted case law.

Furthermore, requiring the designation to fit within the test developed by Revised Article 9 would accord with federal preemption. The Sixth Circuit noted that the form used by the IRS is valid regardless of state-law provisions

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182 B.R. 443, 444-45 (Bankr. E.D. Va. 1995).

98. 967 F.2d 973.

99. *In re Spearing Tool*, 412 F.3d at 656 (citing *In re Hudgins*, 967 F.2d at 977).

100. *Id.* at 657.

101. A uniform regulation also deals with the details of filing and has been implemented in many states. A U.C.C. standard search logic implementation guide and model search report are also planned. See Trish Bogenrief & Paul Hodnefield, *Filing Officer UCC Summit Meeting May Affect UCC Search and Filing Best Practices*, SECURED LENDER, Jan./Feb. 2006, at 24, 24.

102. *In re Spearing Tool*, 412 F.3d at 657.



addressing form or content of the lien notice.<sup>103</sup> As the District Court for the Eastern District of Michigan emphasized, however, “filling out a form correctly does not implicate the same concerns as creating a different form for different states,”<sup>104</sup> which was the Supreme Court’s main concern in *Union Central Life Insurance*. Adoption of the standard in U.C.C. section 9-503 in no way would impair the IRS’s ability to use its Form-668 for notice in all fifty states.

In further support of its policy of uniformity, the Sixth Circuit cited *Kimbell Foods* in its conclusion that “prompt, effective tax collection trumps” inconveniences caused to secured creditors.<sup>105</sup> In relying on *Kimbell Foods* to support this conclusion, however, the Sixth Circuit disregarded much of what the U.S. Supreme Court stated in that case. In *Kimbell Foods*, the Supreme Court examined lien priority resulting from federally guaranteed loans of SBA and FHA lending programs, and not federal tax liens.<sup>106</sup> Nevertheless, the Supreme Court stated that federal revenue policy must consider existing credit markets and state priority rules, and that protective measures must be in place so that federal revenue policy is carried out in a manner that is not disruptive to these systems.<sup>107</sup> The Supreme Court even cited the Federal Tax Lien Act of 1966 as providing “evidence that treating the United States like any other lender would not undermine federal interests.”<sup>108</sup> The Supreme Court quoted the Senate report, indicating that the purpose of these amendments was to prevent the impairment of secured commercial financing transactions by “moderniz[ing] . . . the relationship of Federal tax liens to the interests of other creditors.”<sup>109</sup> According to the Supreme Court, courts must consider congressionally placed limitations to protect creditors against unrestricted federal priority when courts attempt to fill in the gaps left by Congress.<sup>110</sup> The sufficiency of designations on federal tax lien notices is one of these gaps. When the regulations merely state that the notice of federal tax liens must “identify the taxpayer,” courts must determine how that should be done. The

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103. *Id.* at 655 (quoting Treas. Reg. § 301.6323(f)-1(d)(1) (as amended in 1994)).

104. *Crestmark Bank v. United States (In re Spearing Tool & Mfg. Co.)*, 302 B.R. 351, 354 (E.D. Mich. 2003), *rev’d*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006); *see also* Edmund S. Whitson III, “*Spearing*” the Secured Creditor: Sixth Circuit Applies “Bluebook” Rule to IRS Lien Notice Requirements, *AM. BANKR. INST. J.*, Sep. 2005, at 24, 24.

105. *In re Spearing Tool*, 412 F.3d at 657.

106. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 718, 723 (1979).

107. *Id.* at 734-35; *see also* Whitson, *supra* note 104, at 65.

108. *Kimbell Foods*, 440 U.S. at 738 (citing Federal Tax Lien Act of 1966, Pub. L. No. 89-719, sec. 101, § 6323, 80 Stat. 1125, 1125-32).

109. *Id.* (alteration in original) (omission in original) (quoting S. REP. NO. 89-1708, at 1 (1966)).

110. *Id.*

Supreme Court stated in *Kimbell Foods* that courts should look to the U.C.C. as nondiscriminatory state law to govern this area left open by Congress.<sup>111</sup> The Supreme Court earlier recognized this policy in the commercial arena in *Clearfield Trust Co. v. United States*<sup>112</sup> when it stated that as a drawee of commercial paper, the United States stands in no better position than any other drawee, and that “the United States does business on business terms.”<sup>113</sup>

## 2. *The Hollow Test: No Standards, No Precedence, No Guidance*

Both the manner in which the Sixth Circuit established its new standard of a reasonable and diligent electronic search and the approach it took in applying this standard are problematic. Because the physical index is on its way to extinction, the court stated that the old standard of the reasonable and diligent search and the cases that promote that standard “mean little here.”<sup>114</sup> This realization, however, came only after the court used those cases to frame its “critical issue” in *In re Spearing Tool*, namely, that whether the IRS sufficiently identified Spearing depended on “whether a ‘reasonable and diligent search would have revealed the existence of the notices of the federal tax liens under these names.’”<sup>115</sup> Further, although the court announced the new reasonable and diligent electronic search test,<sup>116</sup> the court failed to explain how one conducts such a search, or how a searcher satisfies the test. The court merely concluded that, in this case, the creditor should have searched under different variations of the debtor’s name.<sup>117</sup> The court, however, was unwilling to extend this obligation beyond the facts of this particular case.<sup>118</sup> According to the Sixth Circuit, variations including the abbreviation “Mfg.” and the ampersand are “of course, most common abbreviations,” and, therefore, Crestmark should have conducted searches using them.<sup>119</sup> This conclusion, however, left open the question as to which abbreviations are in the category of “most common abbreviations.” The court did not give any insight into this issue. It simply explained that these two abbreviations are “so common that, for example, we use them as a rule in our case citations.”<sup>120</sup>

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111. *Id.* at 739.

112. 318 U.S. 363 (1943).

113. *Id.* at 369 (quoting *United States v. Nat’l Exch. Bank*, 270 U.S. 527, 534 (1926)).

114. *United States v. Crestmark Bank (In re Spearing Tool & Mfg. Co.)*, 412 F.3d 653, 656 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

115. *Id.* (quoting *Tony Thornton Auction Serv., Inc. v. United States*, 791 F.2d 635, 639 (8th Cir. 1986)).

116. *Id.*

117. *Id.*

118. *Id.*

119. *Id.*

120. *Id.*

Undoubtedly, the court was influenced by the fact that the Michigan Secretary of State's office had suggested that Crestmark search under the name variation.<sup>121</sup> Unfortunately for Crestmark, the Sixth Circuit focused on the fact that Crestmark received a handwritten note included in its search results from the Secretary of State's office recommending that it search under the name "Spearing Tool & Mfg. Company, Inc."<sup>122</sup> The court's reliance on this note as evidence that Crestmark did not conduct a reasonable and diligent electronic search has been criticized as an exercise of twenty-twenty hindsight.<sup>123</sup> Regardless, the Sixth Circuit still faulted Crestmark for failing to search using an incorrect name instead of faulting the IRS for filing the notice under the incorrect name in the first place.<sup>124</sup> Thus, this evidence is not as persuasive as it first appears, and should not have distracted the court from the more important policy issue in the case.

The Sixth Circuit's creation of a new test was based on short-sighted considerations and is problematic for future litigants. After creating a new test, the court limited its holding to the particular facts in this case, stating, "We express no opinion about whether creditors have a general obligation to search name variations."<sup>125</sup> The Sixth Circuit failed to provide an example of what constitutes a reasonable and diligent electronic search. The court did not determine what variations a creditor must consider when searching for federal tax liens. The court did not even determine if a creditor has a duty to search name variations at all. Thus, *In re Spearing Tool* provides no guidance on how the Sixth Circuit will decide, or how any other court should decide, the issue of sufficient notice when an incorrect name is used in the future. Rather than adopting the clear rules of U.C.C. sections 9-503(a)(1) and 9-506 to provide guidance, the court indicated that this issue will be decided on a case-by-case basis that completely depends on facts before the court. Such a ruling completely frustrates the court's stated policy goal of uniformity and will only lead to costly litigation each time a case presents this issue. The ruling in *In re Spearing Tool* makes searching for federal tax liens a guessing game, and produces a test that is as equally problematic as its predecessor.

#### *B. Revised Article 9: Placing the Burden Where It Belongs*

The reasonable and diligent electronic search standard set forth by the Sixth Circuit places the burden on the searcher rather than the filer in determining whether the IRS filing provided sufficient notice of the federal tax lien. The

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121. *Id.*

122. *Id.* at 655-56.

123. Sayre & Pierce, *supra* note 47, at 32.

124. *In re Spearing Tool*, 412 F.3d at 656-57.

125. *Id.* at 656.

test focuses on whether the searcher did enough to gain notice of the federal tax lien instead of focusing on whether the IRS did enough to provide adequate notice to third parties of its interest in the debtor's property. The use of such a standard is not the best policy.<sup>126</sup> It places the risk of insufficient notice on the searcher when the IRS, as the secured party, could easily prevent the problem by filing under the debtor's correct name in the first place.

The better policy is that set forth in Revised Article 9. The filing rules of Revised Article 9 place the burden of providing sufficient notice on the secured party filing the notice,<sup>127</sup> because this party is in the best position to ensure that notice problems never arise. Part five of Revised Article 9, which governs filing, was "substantially rewritten to simplify the statutory text and to deal with numerous problems of interpretation and implementation that have arisen over the years."<sup>128</sup> Recognizing the problems of the subjective standard, the authors of Revised Article 9 created a practical test that made determining whether a name is sufficient objectively verifiable.

The Sixth Circuit should have adopted the Revised Article 9 test as the standard for the sufficiency of designations on federal tax lien notices. In *In re Kinderknecht*<sup>129</sup> the Bankruptcy Appellate Panel for the Tenth Circuit cited "four practical considerations" for requiring financing statements to state the debtor's legal name pursuant to U.C.C. section 9-503.<sup>130</sup> Such a requirement (1) sets a clear test for filers, (2) sets a clear test for searchers, (3) will avoid litigation, and (4) is not burdensome on the filer.<sup>131</sup> The court held that when a search conducted under a debtor's correct name does not disclose any filings, "parties in interest should be able to presume that the debtor's property is not

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126. At first glance, such a standard does appear to be consistent with U.C.C. section 9-517. This section provides that a filing-office error does not render an otherwise effective record ineffective, and places the risk of loss caused by the error on the searcher who relies on the error. U.C.C. § 9-517 (amended 2000), 3 U.L.A. 397 (2002). This section applies, however, when the secretary of state's office incorrectly indexes a properly filed financing statement (containing the debtor's correct name), not when government errors are made in general, such as when the IRS uses the incorrect name on a notice of federal tax lien. *Id.* cmt. 2, 3 U.L.A. 397 (2002). The latter type of error is more closely related to the issue addressed by U.C.C. section 9-516, which gives effect to a filing that is wrongfully rejected by the secretary of state's office but not against a buyer who gives value for the collateral and whose reliance on the absence of the filing is reasonable. *Id.* § 9-516(d), 3 U.L.A. 391 (2002).

127. *See id.* §§ 9-503, 9-506, 3 U.L.A. 357-58, 362-63 (2002).

128. *Id.* § 9-101 cmt. 4(h), 3 U.L.A. 44-46 (2002).

129. *Clark v. Deere & Co. (In re Kinderknecht)*, 308 B.R. 71 (B.A.P. 10th Cir. 2004) (construing Kansas law under Revised Article 9 as requiring the secured creditor to designate an individual debtor by his legal name on a financing statement and invalidating a financing statement using a nickname).

130. *Id.* at 75.

131. *Id.* at 75-76.

encumbered, and they should not be charged with guessing what to do next if the legal name search does not result in any matches.”<sup>132</sup> While the Tenth Circuit’s Bankruptcy Appellate Panel was not faced directly with a federal tax lien, the four “practical considerations” are equally applicable when the creditor is the federal government. Computer databases have replaced physical indexes, and the new provisions of Revised Article 9 represent what is commercially reasonable in the face of new technology. Crestmark could not search through a physical index for liens in the U.C.C. filing office, in which case it probably would have noticed the incorrectly-named federal tax liens. Instead, Crestmark could only submit the debtor’s name under which it wished to search for liens to the Secretary of State’s office, whose electronic-search technology looked only for exact matches.<sup>133</sup> Crestmark should have been able to rely on its searches and not forced to guess other names under which possible federal tax liens might be filed.

*1. Clear Test: Beneficial to IRS as Filer*

The first practical consideration provided by the *In re Kinderknecht* court was that “mandating the debtor’s legal name sets a clear test so as [to] simplify the drafting of financing statements.”<sup>134</sup> While the IRS would have lost *In re Spearing Tool* had the Sixth Circuit adopted the logic of Revised Article 9, a clear test would have been established to the benefit of the IRS. For example, if the IRS uses the debtor’s correct legal name on federal tax lien filings, actual notice of the lien and the government’s priority on the debtor’s property will always be provided to the party who searches using the debtor’s correct legal name. The IRS would know that it has provided sufficient notice of its interest to preclude any subsequently filed competing interests from gaining priority over the federal tax lien. Thus, the IRS would not be subject to a court’s interpretation as to whether a later secured party, who claimed no notice of the IRS lien, conducted a reasonable and diligent electronic search, taking priority over the IRS.

*2. Clear Test: Beneficial to Searchers*

Second, the *In re Kinderknecht* court stated that “setting a clear test simplifies the parameters of UCC searches.”<sup>135</sup> For a third party searching for encumbrances on the property of a potential borrower, the Sixth Circuit’s

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132. *Id.* at 76-77.

133. *United States v. Crestmark Bank (In re Spearing Tool & Mfg. Co.)*, 412 F.3d 653, 655 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

134. *In re Kinderknecht*, 308 B.R. at 75.

135. *Id.*

decision makes the process more difficult and increases uncertainty.<sup>136</sup> This decision will require secured lenders to increase their efforts and costs in searching for hidden federal tax liens as well as potential federal tax liens that may not even exist, even though Revised Article 9 has eliminated these problems when searching for U.C.C. financing statements.<sup>137</sup> To discover potential tax liens, the Sixth Circuit's test requires Crestmark and other secured creditors to request as many official searches as it takes to cover possible variations in the spelling and form of a debtor's registered name.<sup>138</sup> Additionally, the Sixth Circuit's ruling leaves open the possibility that the IRS could use an organization's trade name on the notice of federal tax lien, an option explicitly foreclosed to all other secured parties in the Article 9 revisions.<sup>139</sup> As a result of the Sixth Circuit's ruling, a third party should also search for tax liens under trade names and any variations of them to be certain that no such liens exist. Thus, a creditor searching for a federal tax lien under this standard "must guess at not only what variant [the IRS] might have used but also search under a potentially enormous number of spelling variations."<sup>140</sup> The Eastern District Court of Michigan correctly held that this standard was unreasonable in today's environment.<sup>141</sup> Under a reasonable and diligent electronic search standard, as with the reasonably diligent searcher standard used prior to Revised Article 9, "a searcher would never know when the scope of the search was adequate, even where the name is objectively verifiable."<sup>142</sup>

Conversely, the Article 9 revisions "reduce transaction costs by minimizing incorrect matches and the corresponding need to conduct further due diligence" to determine the applicability of the incorrect matches and eliminate the expense of conducting multiple searches.<sup>143</sup> Expanding the boundaries of one's search in an attempt to find possible incorrectly designated federal tax lien filings will produce notices that are not applicable to the subject debtor. The searcher must then take the necessary steps to determine that these extra notices do not, in fact, involve the property of the applicable debtor.<sup>144</sup> Thus, in addition to conducting multiple searches, a third-party searcher must then

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136. Barkley Clark & Barbara Clark, *IRS Tax Lien Has Priority over Security Interest in Accounts*, CLARKS' SECURED TRANSACTIONS MONTHLY, Aug. 2005, at 6, 7.

137. Clark & Clark, *supra* note 28, at 1.

138. *Id.*

139. U.C.C. § 9-503(c) (amended 2000), 3 U.L.A. 358 (2002); *see also* Sayre & Pierce, *supra* note 47, at 32.

140. Clark & Clark, *supra* note 10, at 4.

141. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 302 B.R. 351, 356-57 (E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

142. Sayre & Pierce, *supra* note 47, at 32.

143. *Id.* at 30.

144. *Id.*

inquire into the relevancy of the extra results produced by those searches. This inefficiency increases transaction costs by decreasing accuracy and certainty. The problem with these “fishing expeditions” is that a lot of unnecessary fish are caught, undermining the efficiency and certainty of the system developed by Revised Article 9.<sup>145</sup> Because a searcher must “cast a wider net . . . to capture an IRS filing,” the *In re Spearing Tool* decision forces searchers to be creative to “bail out dumb filers.”<sup>146</sup>

In conducting a search for encumbrances on a debtor’s property, the logical place to begin is with the debtor’s legal name.<sup>147</sup> The simplest solution to problems like the one presented in *In re Spearing Tool* is requiring the IRS to provide the correct legal name of the debtor on the filing of the federal tax lien, possibly preventing the need for litigation in the first place.<sup>148</sup> The standard under Revised Article 9 “does not burden searchers with the obligation to dream up every potential error and name variation and perform searches under all possibilities.”<sup>149</sup> Instead, a searcher can increase certainty and reduce transaction costs by relying on a single search to produce all encumbrances on a debtor’s property.<sup>150</sup> As the Michigan federal district court stated in its holding for Crestmark, “Gone are the days of large alphabetical books, where a reasonable searcher would likely find a misspelled (or mistakenly abbreviated) name because it would appear in close proximity to where a lien with a correctly spelled name would have appeared.”<sup>151</sup> In an age where electronic searching dominates, the policy in Revised Article 9 represents the standard of what is commercially reasonable. “Fairness to third parties dictates” that an IRS lien that would not surface under the Revised Article 9 standard should not have priority over the perfected interests of subsequent creditors.<sup>152</sup>

### 3. Clear Test: Reduction of Litigation

Third, the *In re Kinderknecht* court proposed that “requiring the debtor’s legal name will avoid litigation as to the commonality or appropriateness of a

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145. *Id.* at 32 (“[T]he overall system would function more smoothly if everyone, including the IRS, were forced to play by the same set of rules.”).

146. Clark & Clark, *supra* note 31, at 2.

147. Barkley Clark & Barbara Clark, *Tenth Circuit Bankruptcy Appellate Panel Nixes Nicknames in UCC Financing Statements*, CLARKS’ SECURED TRANSACTIONS MONTHLY, May 2004, at 1, 2.

148. Clark & Clark, *supra* note 10, at 4.

149. *Id.*

150. Sayre & Pierce, *supra* note 47, at 28, 30.

151. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 302 B.R. 351, 357 (E.D. Mich. 2003), *rev’d*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006).

152. *Id.*

debtor's nickname, and as to whether a reasonable searcher would have or should have known to use the name."<sup>153</sup> As noted, the Sixth Circuit's reasonable and diligent electronic search test is another fact-dependent standard no different than the old reasonably diligent searcher test used prior to the adoption of Revised Article 9.<sup>154</sup> The Sixth Circuit's decision results in an inefficient double standard between the filings of the IRS and those of other creditors, because it requires litigation over the facts and circumstances of the particular case to determine the sufficiency of the designation.<sup>155</sup> Moreover, the application of the standard is unpredictable because prior case law does not provide much guidance on how such litigation will be resolved. Compliance with the Revised Article 9 standard, however, can easily be ascertained.<sup>156</sup> As the standard for determining the sufficiency of notice of federal tax liens, the "reasonable and diligent electronic search" standard will only continue to breed litigation and its attendant expenses.<sup>157</sup> The cases that follow the Sixth Circuit's test will continue to be as muddled as the previous case law.

#### 4. Clear Test: Not Burdensome on the IRS

The final practical consideration provided by the *In re Kinderknecht* court was that "obtaining a debtor's legal name is not difficult or burdensome for the creditor taking a secured interest in a debtor's property."<sup>158</sup> Requiring that the IRS provide a corporation's complete legal name on a federal tax lien is not burdensome on the IRS.<sup>159</sup> A corporate debtor's legal name is included in its articles of incorporation, an easily accessible public record.<sup>160</sup> This information can also usually be found on the Internet from the secretary of state's website for the business's state of incorporation.<sup>161</sup> Such a search is quick and incurs little to no cost.<sup>162</sup> If an ordinary secured lender can verify the debtor's name without hardship, there is no reason to think the IRS cannot do the same.

Requiring the IRS to follow the same rules as everyone else also seems to conform with the U.S. Supreme Court's decision in *United States v. Kimbell*

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153. Clark v. Deere & Co. (*In re Kinderknecht*), 308 B.R. 71, 75-76 (B.A.P. 10th Cir. 2004).

154. Sayre & Pierce, *supra* note 47, at 32; Whitson, *supra* note 104, at 65.

155. Clark & Clark, *supra* note 31, at 3.

156. *Id.*

157. *Id.*

158. *In re Kinderknecht*, 308 B.R. at 76.

159. Crestmark Bank v. United States (*In re Spearing Tool & Mfg. Co.*), 302 B.R. 351, 357 (E.D. Mich. 2003), *rev'd*, 412 F.3d 653 (6th Cir. 2005), *cert. denied*, 127 S. Ct. 41 (2006); *see also* Whitson, *supra* note 104, at 65.

160. Mark Ovington, *Filing Errors: Getting the Debtor's Name Right*, CLARKS' SECURED TRANSACTIONS MONTHLY, Jan. 2005, at 3, 5.

161. *Id.* at 4.

162. *Id.*



*Foods, Inc.* There, the Court held that, as a matter of federal law, nondiscriminatory state law such as the U.C.C. should govern the priority of liens favoring the U.S. government.<sup>163</sup> Thus, the provisions of the U.C.C. should apply to determine adequate notice to the extent that adequate notice is not resolved by the federal statute itself. Because neither the Federal Tax Lien Act nor the Treasury Regulations enforcing it specifically provide how the notices of the liens should identify the taxpayer, but merely state that the taxpayer should be identified, the identification rules of U.C.C. Revised Article 9 should govern these types of conflicts. In short, the Supreme Court's rationale in *Kimbell Foods* suggests that it is *not* burdensome on the federal government to require it to conduct business on the same terms as its citizens.

#### V. Conclusion

In the end, *In re Spearing Tool* produces a standard for judging the sufficiency of name designations on IRS notices of federal tax liens that is no different than the old standard. The Sixth Circuit could have, and should have, required the IRS to play by the same rules as other secured creditors by adopting the provisions of U.C.C. Revised Article 9 as the standard for determining the sufficiency of name designations on IRS tax lien notices. Unfortunately, the U.S. Supreme Court recently denied certiorari in this case.<sup>164</sup> Therefore, until another jurisdiction rules otherwise or there is once again a change in the FTLA or the Treasury Regulations to modernize federal tax lien practice in conformity with the U.C.C., practitioners must be aware of the possibility of hidden tax liens and cannot rely on the commercially reasonable standards of the U.C.C.

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163. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 740 (1979).

164. *Crestmark Bank v. United States*, 127 S. Ct. 41 (2006).